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In the Supreme Court of the United States

OCTOBER TERM, 1988

KENTUCKY WEST VIRGINIA GAS COMPANY AND EQUITABLE GAS COMPANY, A DIVISION OF EQUITABLE RESOURCES, INC., PETITIONERS

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION, ET AL., RESPONDENTS

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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QUESTIONS PRESENTED

1. Whether the "filed rate" doctrine, reaffirmed by this Court in *Mississippi Power & Light Co.* v. *Mississippi*, No. 86-1970 (June 24, 1988), and *Nantahala Power & Light Co.* v. *Thornburg*, 476 U.S. 953 (1986), requires a state public utility commission to allow a utility to recover through its retail rates a fixed, unavoidable cost incurred by the utility pursuant to a contract with a pipeline embodied in a tariff approved by the Federal Energy Regulatory Commission.

2. Whether the retroactive application of a new ratemaking standard to bar a utility from recovering costs incurred by the utility prior to the adoption of the new standard, and previously recoverable, constitutes a taking of property without just compensation in violation of the Due Process Clause of the Fourteenth Amendment.

3. Whether a state public utility commission order directing a utility to hire separate and independent counsel to represent the interests of ratepayers in proceedings before the Federal Energy Regulatory Commission violates the utility's due process right to manage its legal affairs free from arbitrary governmental interference.

PARTIES TO THE PROCEEDING AND RULE 28.1 STATEMENT

In addition to the parties listed in the caption, Linda C. Taliaferro, Frank Fischl, and Bill Shane, commissioners of the Pennsylvania Public Utility Commission, and the Federal Energy Regulatory Commission were defendants in the district court and are respondents in this Court. The Office of the Attorney General for the Commonwealth of Pennsylvania and the Pennsylvania Office of the Consumer Advocate intervened below and are respondents in this Court. The American Gas Association participated below as *amicus curiae*.

Pursuant to Rule 28.1 of the Rules of this Court, petitioner Kentucky West Virginia Gas Company states that its parent company is Equitable Resources, Inc.; petitioner Equitable Gas Company states that it is a division of Equitable Resources, Inc. Petitioners' only other affiliate or subsidiary (other than wholly-owned subsidiaries) is Metscan Technology Partners, a partnership.

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v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION, ET AL., RESPONDENTS

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

Kentucky West Virginia Gas Company and Equitable Gas Company, a division of Equitable Resources, Inc., respectfully petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Third Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-40a) is reported at 837 F.2d 600. The prior opinion of the court of appeals (App., *infra*, 80a-95a) is reported at 791 F.2d 1111. The opinion of the district court (App., *infra*, 41a-79a) is reported at 650 F. Supp. 659. The prior opinion of the district court (App., *infra*, 96a-104a) is reported at 620 F. Supp. 1458. The order of the Pennsylvania Public Utility Commission (App., *infra*, 107a-163a) is unreported.

JURISDICTION

The judgment of the court of appeals (App., *infra*, 105a) was entered on January 19, 1988, and a petition for rehearing was denied on February 16, 1988 (App.,

infra, 106a). Pursuant to orders issued by Justice Brennan, the time for filing a petition for a writ of certiorari was extended to and including July 15, 1988. The jurisdiction of this Court rests upon 28 U.S.C. 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The relevant provisions of the United States Constitution, the Natural Gas Act, 15 U.S.C. 717 *et seq.*, and Pennsylvania Act 74, 66 Pa. Cons. Stat. Ann. 1307(f), 1317-1318 (Purdon 1988 Supp.), are reprinted at pages 164a-175a of the appendix of this petition.

STATEMENT

The extent to which federal statutory and constitutional principles circumscribe state utility regulators has been a subject of considerable controversy in recent years. See, *e.g.*, *Schneidewind* v. *ANR Pipeline Co.*, 108 S.Ct. 1145 (1988); *Nantahala Power & Light Co.* v. *Thornburg*, 476 U.S. 953 (1986); *Transcontinental Gas Pipe Line Corp.* v. *State Oil & Gas Board*, 474 U.S. 409 (1986); see also *Duquesne Light Co.* v. *Barasch*, prob. jur. noted, No. 87-1160 (Mar. 7, 1988); *Northwest Central Pipeline Corp.* v. *State Corporation Comm'n*, prob. jur. noted, No. 86-1856 (May 23, 1988). In this case, intervention by this Court is necessary because respondents have transgressed federal limits upon their regulatory authority in a manner that, if not corrected, is likely to generate considerable confusion over the proper relationship between state and federal regulatory authority and to unsettle the expectations of public utility investors. Indeed, respondents' violation of federal law, sanctioned by the court of appeals, is virtually identical to the impermissible exercise of state regulatory power overturned by this Court in its recent decision in *Mississippi Power & Light Co.* v. *Mississippi*, No. 86-1970 (June 24, 1988).

1. The Natural Gas Act, 15 U.S.C. 717 *et seq.*, authorizes the Federal Energy Regulatory Commission (FERC) to regulate both the interstate transportation of natural gas and sales of natural gas "in interstate commerce * * * for resale" (15 U.S.C. 717(b)). Under Sections 4 and 5 of the Act, 15 U.S.C. 717c and 717d, the Commission oversees the price and other terms of sales within its jurisdiction, evaluating rates and charges as well as all rules, regulations, practices, and contracts affecting those rates and charges, to determine whether they are just and reasonable.[1]

The Natural Gas Act allows the states to regulate the rates paid by retail natural gas customers (see 15 U.S.C. 717(b)), but, of course, such regulation is circumscribed by the duty to refrain from actions that contradict or undermine federal regulation. See, *e.g.*, *Mississippi Power*, slip op. 17 ("States may not bar regulated utilities from passing through to retail consumers FERC-mandated wholesale rates"). This case involves an application by petitioner Equitable Gas to respondent Pennsylvania Public Utility Commission (PUC) for an increase in retail natural gas rates to reflect costs incurred by Equitable in purchasing natural gas at a federally-established rate during the period from July 1983 through December 1984.

Like other states and the FERC, Pennsylvania permits a utility to change its rates to reflect changes in fuel costs. Under Pennsylvania Act 74, which became effective on July 30, 1984, a utility is entitled to recover its

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[1] The Natural Gas Policy Act of 1978 eliminated price regulation of wellhead sales of "new" gas and established a timetable for the gradual decontrol of all wellhead sales. See generally *Public Service Comm'n* v. *Mid-Louisiana Gas Co.*, 463 U.S. 319, 332-336 & n.14 (1983). That limitation upon the Commission's regulatory authority is not relevant in this case, which involves purchases by a regulated local distribution company from regulated interstate pipelines.

gas purchase costs only if it demonstrates that its gas purchasing decisions satisfied the new standard set forth in Act 74—"that the utility is pursuing a least cost fuel procurement policy, consistent with the utility's obligation to provide safe, adequate and reliable service to its customers." 66 Pa. Cons. Stat. Ann. 1318(a) (Purdon 1988 Supp.).[2] If it is found, after application of the Act 74 standard, that the revenues received by the utility exceeded the allowable gas purchase costs, all of the excess revenues must be refunded to the utility's customers through rate reductions; conversely, if revenues were below allowable costs, the utility may recover the shortfall through increased rates (*id.* at § 1307(f)(5)).

2. Petitioner Equitable Gas Company sells natural gas at retail to approximately 240,000 consumers in and around the Pittsburgh, Pennsylvania area.[3] It obtains approximately 80% of its natural gas supplies through wholesale purchases from three interstate pipeline companies: Kentucky West Virginia Gas Company, which is an affiliate of Equitable; Texas Eastern Transmission Corporation; and Tennessee Gas Pipeline Company. Equitable purchases gas from these companies at rates and under terms and conditions set forth in tariff schedules approved by the FERC pursuant to its authority to regulate rates under the Natural Gas Act. App., *infra*, 3a-4a.[4]

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[2] Section 1318(a) provides that the PUC must make a number of specific findings before it concludes that a utility has satisfied this standard, including finding that the utility "fully and vigorously represented the interests of its ratepayers in proceedings before the Federal Energy Regulatory Commission"; that, in the course of its dealings with its suppliers, the utility has "taken all prudent steps" to obtain low-cost gas supplies; and that the utility has not withheld low-cost gas from the market. Section 1318(b) provides that additional special findings are required when, as here, a utility has purchased natural gas from an affiliate.

[3] Equitable also serves consumers in West Virginia and Kentucky.

[4] Equitable obtains the remainder of its supplies from its own gas wells in Pennsylvania and West Virginia and from wells owned by independent producers in those states.

The period at issue in this case is July 1983 through December 1984 (all but five months of which preceded the effective date of Act 74). During that period, Equitable was bound by long-term contracts with the three pipelines; moreover, those contracts were themselves embodied in the pipelines' FERC-approved tariffs, under which the pipelines agreed to supply Equitable with specified volumes of gas at specified rates (usually expressed in dollars per thousand cubic feet). While Equitable could to some extent reduce the quantities of gas it purchased, the contracts and tariffs contained "minmum bill" provisions, under which Equitable was required to pay for a specified proportion of the gas to which it was entitled under its contract with the pipeline, whether or not it actually took delivery of the gas. See, *e.g.*, C.A. App. 903-940.[5]

During the early 1980s, there was a sharp decline in the demand for natural gas in Equitable's service area. As a consequence, beginning a year or more prior to the period covered by the application at issue in this case, Equitable's need for gas fell below the amounts it was obliged to purchase by virtue of the minimum bill obligations under its FERC-approved supply contracts. Equitable thereby became obligated to pay its interstate pipeline suppliers for gas not taken. Equitable responded by pursuing a strategy, in months when purchases were below minimum bill levels, of reducing the amounts of gas taken from each of its three pipeline suppliers on a pro rata basis. Equitable believed that such a strategy would result in the lowest cost for gas consistent with ensuring the company's access to reliable long-term gas supplies. App., *infra*, 21a; C.A. App. 263-264, 280, 364-365. This pro rata reduction purchase strategy was ap-

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[5] Minimum bill provisions have been extremely common in wholesale natural gas rates. For a discussion of the reasons that suppliers include minimum bill provisions in their tariffs, see *Wisconsin Gas Co.* v. *FERC*, 770 F.2d 1144, 1150-1151 (D.C. Cir. 1985), cert. denied, 476 U.S. 1114 (1986).

proved by the PUC in connection with its review of Equitable's gas purchases for the period immediately preceding that at issue here. *Gas Rate Cost No. 5*, 58 P.U.R. 4th 369, 380 (Pa. P.U.C. 1984).[6]

On March 1, 1985, Equitable initiated a proceeding before the Pennsylvania Public Utility Commission seeking a rate increase on the ground that its actual gas costs during the period July 1983 through December 1984 exceeded its revenues. By its order, the PUC retroactively disallowed approximately $14.3 million of these purchased gas costs, which consisted entirely of purchases from petitioner Kentucky West Virginia Gas Company in partial satisfaction of Equitable's minimum bill obligation.[7]

The question on which the PUC focused was whether the costs incurred by Equitable in purchasing gas from its affiliate Kentucky West, more than two-thirds of which were incurred prior to Act 74's effective date, comported with Act 74's least-cost procurement standard.[8] Equitable contended that the purchases from Ken-

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[6] Equitable gave notice to the three suppliers that, in its view, the considerable oversupply of gas constituted *force majeure* that excused Equitable from its obligation under the minimum bill provisions of the suppliers' tariffs to pay for gas not taken. App., *infra*, 21a. Equitable's unilateral declaration of *force majeure* did not, of course, itself suffice to relieve Equitable of its legal obligation to make the minimum bill payments. See note 13, *infra*.

[7] In a second part of its application, Equitable sought increases in its future rates, based on its anticipated gas purchase costs for the period from September 1985 through August 1986. The PUC modified that request. It prospectively required Equitable to purchase quantities of gas from what the PUC found to be lower cost suppliers. Thus, the PUC directed Equitable to purchase more gas from Texas Eastern Transmission Corporation and decrease its projected purchases from Tennessee Gas Pipeline Corporation and from independent producers in the Hawks Nest area of West Virginia. App., *infra*, 119a-132a.

[8] The PUC rejected Equitable's contention that Act 74 could not be applied retroactively to assess the reasonableness of costs incurred prior to the Act's effective date. App., *infra*, 133a-137a.

tucky West met this standard because the minimum bill provision in Kentucky West's FERC-approved tariff required Equitable to pay for the Kentucky West gas whether or not it took delivery of that gas. App., *infra*, 140a. *Thus, even if Equitable had purchased gas from another supplier, the FERC-approved tariff required it to pay Kentucky West's minimum bill.*

The PUC found that the purchases from Kentucky West violated the least-cost purchase requirement of Act 74 because gas available to Equitable from its own production and from local suppliers was cheaper than the gas purchased from Kentucky West. It based this conclusion solely upon the basic rates charged by the various suppliers, ignoring both Equitable's obligation to pay Kentucky West under the minimum bill provision of the FERC-approved tariff and the impact of the minimum bill provision on the relative net costs of Equitable's sources of natural gas supply. Applying the standard set forth in Act 74, the PUC concluded that reducing the volumes of gas acquired from Kentucky West would have cut Equitable's costs by an amount greater than the $14.3 million in costs claimed by Equitable; it therefore declined to allow a rate increase to cover those costs. App., *infra*, at 142a-143a.

In the course of making the specific findings mandated by Act 74 concerning Equitable's purchasing strategy (see note 2, *supra*), the PUC considered whether Equitable had "fully and vigorously represented the interests of its ratepayers in proceedings before the Federal Energy Regulatory Commission" (66 Pa. Cons. Stat. Ann. 1318(a)(1) (Purdon 1988 Supp.)). The PUC stated that, with respect to FERC proceedings to set the rates charged by Equitable's affiliate, Kentucky West, "[a] serious question arises as to whether [vigorous representation of the ratepayers' interests] can take place in view of Equitable's present corporate structure." App., *infra*, 148a. In order to eliminate what it found to be an obstacle to Equitable's performance of this statutory

duty, the PUC ordered Equitable to "obtain independent representation of its interest by legal counsel and technical support staff wholly separate from Kentucky West" in all FERC rate proceedings involving Kentucky West (*ibid.*).

3. Following the issuance of the PUC's order, Equitable, together with its affiliate, Kentucky West, commenced the present action in the United States District Court for the Middle District of Pennsylvania, joining as defendants the Pennsylvania Public Utility Commission, the members of that Commission, and the Federal Energy Regulatory Commission. Equitable sought declaratory and injunctive relief directing the PUC to allow Equitable to recover the $14.3 million in incurred gas costs and invalidating the portion of the PUC's order requiring Equitable to employ separate counsel to oppose the interests of an affiliated company, Kentucky West, in that company's FERC rate proceedings. C.A. App. 9-25.

The district court entered judgment in favor of respondents (see App., *infra*, 41a-79a).[9] It found that neither Act 74 nor the PUC's order violated the Supremacy Clause and that Act 74 did not violate either the Commerce Clause or the Equal Protection Clause.[10]

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[9] The district court had initially concluded that it should abstain so that Equitable's constitutional claims could be resolved in the state court proceeding (App., *infra*, 96a-104a). That determination was reversed by the court of appeals, which remanded the case for determination on the merits by the district court (*id.* at 80a-95a).

Equitable also filed a petition for review of the PUC's order in the Commonwealth Court of Pennsylvania. That court upheld the PUC's determination against several state-law challenges. See *Equitable Gas Co.* v. *Pennsylvania Public Utility Comm'n*, 526 A.2d 823 (Pa. Commw. 1987). Because of the pendency of the federal court action, Equitable did not press its federal claims in the state court proceeding.

[10] The district court declined to rule on Equitable's challenge to the portion of the PUC's order requiring Equitable to retain sepa-

The court of appeals affirmed (App., *infra*, 1a-40a). It first found that Act 74 was not facially invalid under the Supremacy Clause (*id.* at 12a-18a). (That ruling is not at issue here.) The court then turned to Equitable's argument that the manner in which the PUC applied Act 74 in this case violated the Supremacy Clause because it failed to recognize costs actually incurred by Equitable in taking delivery of Kentucky West gas that Equitable was bound under the FERC-approved tariff to pay for. The court of appeals recognized (App., *infra*, 19a) that Equitable's challenge to the statute as applied raised a substantial claim under this Court's decision in *Nantahala Power & Light Co.* v. *Thornburg*, 476 U.S. 953 (1986), but it rejected Equitable's claim for two reasons. Invoking the general principle that federal courts should accord preclusive effect to factual determinations of state administrative agencies, the court deferred to the PUC's implicit conclusion that it was not necessary to consider the minimum bill provision of the FERC-approved tariff in assessing the prudence of Equitable's gas purchases (App., *infra*, 21a-22a). The court went on to reject Equitable's claim for the additional reason that Equitable had not "challenge[d] the evidentiary support for the PUC's findings" by introducing into evidence "mathematical figures * * * establishing what actual costs Equitable had incurred" pursuant to the Kentucky West minimum bill or what minimum bill costs Equitable would have incurred if it had purchased gas from the suppliers identified by the PUC (*id.* at 22a).

The court also rejected Equitable's claim that the PUC's retroactive application of the Act 74 standard to evaluate the reasonableness of gas costs incurred from July 1983 through July 1984—prior to the effective date of Act 74—constituted a taking of property without just

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rate counsel in future proceedings before the FERC, holding that Equitable's claim should be directed to the FERC (App., *infra*, 43a n.4).

compensation in violation of the Due Process Clause of the Fourteenth Amendment. According to the court, Equitable in effect waived the retroactivity objection when it "voluntarily" chose to make use of the Act 74 procedures rather than the statutory procedure for a general rate increase (App., *infra*, 35a).

Finally, the court of appeals held that the PUC did not violate Equitable's constitutional or statutory rights by ordering Equitable to employ separate counsel in future FERC proceedings. The court rejected Equitable's contention that the requirement of separate counsel violated its due process rights on the ground that "[t]he Supreme Court has not recognized a constitutional right to counsel in a civil case or in a civil matter before an administrative agency" (App., *infra*, 37a). The court also held that the PUC's order did not violate the right to assistance of counsel set forth in the Administrative Procedure Act (see 5 U.S.C. 555(b)). It found that the potential for conflict between the interests of Equitable's ratepayers and the interests of Kentucky West justified the requirement of separate and independent counsel to represent the ratepayers' interests before the FERC (App., *infra*, 38a-39a).

REASONS FOR GRANTING THE PETITION

In its recent decision in *Mississippi Power & Light Co.* v. *Mississippi*, No. 86-1970 (June 24, 1988), this Court reaffirmed that "States may not bar regulated utilities from passing through to retail customers FERC-mandated wholesale rates. '* * * When FERC sets a rate between a seller of power and a wholesaler-as-buyer, a State may not exercise its undoubted jurisdiction over retail sales to prevent the wholesaler-as-seller from recovering the costs of paying the FERC-approved rate. . . . Such a 'trapping' of costs is prohibited.'" Slip. op. 17 (quoting *Nantahala Power & Light Co.* v. *Thornburg*, 476 U.S. 953, 970 (1986)). The Court held

that a state could neither enter an order barring the recovery of FERC-mandated costs nor "undertake a 'prudence' review for the purpose of deciding whether to enter [such] an order" (slip op. 17).

The decision of the court of appeals erroneously sanctions the very "trapping" of costs found impermissible by this Court in *Mississippi Power*. Equitable was legally obligated by the minimum bill provision in Kentucky West's FERC-approved tariff to purchase the gas it did, but the PUC nonetheless refused to permit Equitable to recover the cost of those purchases on the ground that they were not prudently incurred costs. *Mississippi Power* holds that the Supremacy Clause bars a state from applying a state-law prudency standard to prevent a utility from recovering costs that the utility was obligated to incur under a FERC-approved tariff. In order to permit the court of appeals to take account of the subsequent decision in *Mississippi Power*, this Court should grant the petition, vacate the judgment of the court of appeals, and remand the case for reconsideration in light of that decision.[11]

The court of appeals failed to correct two other important errors committed by the PUC. First, the PUC applied Act 74's cost recovery standard retroactively, barring Equitable from recovering gas purchase costs incurred long before that statutory standard went into effect and thereby disrupting Equitable's reasonable expectations so as to effect a taking of property without just compensation. Second, the PUC ordered Equitable to engage separate and independent counsel to partici-

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[11] Substantial portions of the opinions below are devoted to the "facial" attack on Act 74, *i.e.*, the claims that *all* purchases of gas at FERC-approved rates are beyond state regulators' power to review for prudency. That claim is not renewed here. Rather, we focus solely on the power of the PUC to disallow costs incurred in purchasing gas that the utility is *obligated* by the FERC and by its contract with the pipeline to purchase.

pate in FERC ratemaking proceedings in opposition to applications by its affiliate, petitioner Kentucky West, in violation of Equitable's due process rights to manage its legal affairs free from arbitrary government interference. The court of appeals' erroneous disposition of these important constitutional issues also warrants review by this Court in the event the case is not remanded as suggested above.

A. The Court Of Appeals' Interpretation Of The Filed Rate Doctrine Conflicts With This Court's Decisions In *Mississippi Power* And *Nantahala*.

1. Section 4(a) of the Natural Gas Act, 15 U.S.C. 717c, endows the Federal Energy Regulatory Commission with exclusive authority to fix the just and reasonable rate for sales of natural gas in interstate commerce. *Arkansas-Louisiana Gas Co.* v. *Hall*, 453 U.S. 571, 577 (1981); see also page 3 & note 1, *supra*. This exclusive authority is safeguarded by what is known as the "filed rate" doctrine, which bars other tribunals from second-guessing the reasonableness of a rate fixed by the Commission. Thus, except for judicial review of the Commission's orders, federal courts may not conclude that the proper rate for a sale within the FERC's jurisdiction is anything other than the rate fixed by the FERC. *Montana-Dakota Utilities Co.* v. *Northwestern Public Service Co.*, 341 U.S. 246, 251-252 (1951). State courts are similarly bound to apply the Commission's determinations. *Arkansas-Louisiana Gas Co.* v. *Hall*, *supra*.

Most significant for purposes of the present case are this Court's decision two years ago in *Nantahala* and its recent decision in *Mississippi Power*. *Nantahala* concerned the proper allocation among related companies of entitlements to purchase low-cost electrical power. The FERC had issued a rate order allocating the low-cost power, but the state public service commission used a different allocation in fixing the rate to be charged to the utility's

retail customers. The question before this Court was whether the state commission's order violated the filed rate doctrine.

The Court explained that the "typical application" of the filed rate doctrine in this context occurs when "a middleman faces a FERC-fixed wholesale rate charged by a power supplier. In that situation, for a state rate-making agency to disregard a FERC-filed rate would clearly be inconsistent with the exclusive federal regulatory scheme over wholesale power prices" (476 U.S. 969). Accordingly, "[w]hen FERC sets a rate between a seller of power and a wholesaler-as-buyer, a State may not exercise its undoubted jurisdiction over retail sales to prevent the wholesaler-as-seller from recovering the costs of paying the FERC-approved rate" (*id.* at 970). The "state utility commission setting retail prices must allow, as reasonable operating expenses, costs incurred as a result of paying a FERC-determined wholesale price" (*id.* at 965). The Court stated that any other result would lead to the impermissible "trapping" of costs at the wholesale level, with the wholesaler obligated to pay the FERC-approved rate on the one hand, and unable to recover those costs in its retail rates on the other.

Although the facts of *Nantahala* did not involve a simple refusal to recognize a FERC-approved cost per unit of power, the Court nonetheless held that the state commission had violated the filed rate doctrine. The Court first observed that the doctrine remained applicable even though the FERC order did not set a monetary rate: "the filed rate doctrine is not limited to 'rates' *per se*: 'our inquiry is not at an end because the orders do not deal in terms of prices or volumes of purchases'" (476 U.S. at 966 (citation omitted)). Because the FERC order "directly affect[ed] Nantahala's wholesale rates by determining the amount of low-cost power that it may obtain, and FERC required Nantahala's wholesale rate

to be filed in accordance with that allocation," the Court concluded that the filed rate doctrine barred the state PUC from basing Nantahala's retail rates upon a different allocation of low-cost power (*id.* at 967).

Like *Nantahala*, *Mississippi Power* concerned the allocation among several entities of electrical power produced by a single plant. The FERC issued an order allocating 33% of the power to Mississippi Power & Light Co. (MP&L), and the state public utility commission permitted MP&L to increase its retail rates to recover the cost of purchasing that power at the FERC-approved wholesale rates. The state supreme court held that the commission erred because it should have reviewed the prudence of MP&L's decision to purchase power from the new plant before permitting MP&L to increase its retail rates to recover the cost of that power.

This Court reversed, holding that the state prudence review was preempted under the filed rate doctrine because the FERC allocation order compelled the state to permit the recovery of the cost of the power allocated to MP&L. "Just as *Nantahala* had no legal right to obtain any more low cost [electric] power than the amount allocated by FERC, it is equally clear that MP&L may not pay for less [high-cost electric] power than the amount allocated by FERC" (slip op. 19).

Application of the *Mississippi Power/Nantahala* principle in the present case is straightforward. The minimum bill provision in the Kentucky West tariff required Equitable to pay for at least two-thirds of the gas to which it was entitled under its contract with Kentucky West. It was not obliged to take actual delivery of this gas, but it was required to pay for it. Equitable thus had an unavoidable obligation, reflected in Kentucky West's FERC-approved tariff, to incur the expenses that the PUC found imprudent under Pennsylvania's least-cost pur-

chase requirement.[12] Since the minimum bill is part of Kentucky West's FERC-approved tariff, and "[o]nce FERC sets * * * a rate, a State may not conclude in setting retail rates that the FERC-approved wholesale rates are unreasonable" (*Nantahala*, 476 U.S. at 966), the PUC was bound to conclude that the purchases from Kentucky West were reasonable and to permit Equitable to recover for them through its retail rates. The PUC's decision barring recovery of these payments results in the very trapping of costs at the wholesale level that the *Mississippi Power* and *Nantahala* Courts identified as the consequence of a violation of the filed rate doctrine: Equitable was obligated by Kentucky West's FERC-approved tariff to purchase the gas and to pay the rate set by the FERC, but Equitable was not permitted to recover those costs in its retail rates.[13]

Contrary to the apparent view of the court of appeals and the PUC, the PUC was not entitled to ignore the constraints of the filed rate doctrine because it was applying a state statute requiring review of the prudence of Equitable's gas purchase decisions. Indeed, this Court rejected just such a contention in *Mississippi Power*. This Court assumed that "it might well be unreasonable

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[12] True, because Equitable's actual purchases were *below* the minimum-bill level, they only partially satisfied Equitable's unconditional, federally-imposed obligation. But Equitable did not seek in this proceeding to recover costs beyond those actually incurred.

[13] Equitable's declaration of *force majeure* does not alter the analysis. First, the declaration related only to gas *not* purchased or paid for (see note 12, *supra*) and not to the purchases actually made in partial fulfillment of the contractual obligation; but it is only the latter that are at issue here. Second, Equitable's unilateral declaration did not vitiate the binding legal effect of the tariff. See, *e.g.*, *Equitable Gas Co.*, 28 F.E.R.C. ¶ 61,235 (1984); see generally 6 *Corbin on Contracts* §§ 1324-1329 (1962) (discussing standard governing proof of *force majeure*); *Nissho-Iwai Co.* v. *Occidental Crude Sales, Inc.*, 729 F.2d 1530, 1539-1542 (5th Cir. 1984) (same).

for a utility to purchase unnecessary quantities of high cost power, even at FERC-approved rates, if it had the legal right to refuse to buy that power" (slip op. 19). But, the Court continued, "if the integrity of FERC regulation is to be preserved, it obviously cannot be unreasonable for MP&L to procure the particular quantity of high-priced [electric] power that FERC has ordered it to pay for" (*ibid.*). Because the FERC order required MP&L to pay for all of the power allocated to it by the FERC, the state could not bar MP&L from recovering the full cost of that power through its retail rates.

Mississippi Power makes clear that, assuming a state utility commission may consider the prudence of a utility's purchasing decisions at all, that prudence inquiry is circumscribed by the filed rate doctrine. State regulators may find a utility imprudent in incurring particular costs only if the utility "had the legal right to refuse to [incur] that [cost]" (*Mississippi Power*, slip op. 19). In the present case, therefore, the PUC was not free to look *only* to unit prices of the various potential suppliers in assessing the prudence of Equitable's gas purchasing decisions. It also was obligated to take account of the fact that the minimum bill provision of Kentucky West's FERC-approved tariff required Equitable to pay for a certain minimum amount of gas each month.[14]

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[14] The Federal Energy Regulatory Commission agrees with this analysis. It stated in its brief in the court of appeals (at 47) that "to the extent that a state commission, in passing on the prudence of a retail distributor in buying from one source rather than another, disregards or ignores the economic consequences of a minimum bill in the wholesale rate schedule approved by FERC for that distributor's actual seller, the state is acting in violation of the 'filed rate' doctrine and thus outside its lawful regulatory authority."

The FERC did not take a position on the factual basis for Equitable's claim but stated that "if the facts are as [petitioners] allege then the Pennsylvania Commission's decision was inconsistent

The record clearly establishes that the PUC in fact ignored the minimum bill provision, in violation of the filed rate doctrine. First, the PUC's opinion never mentions the fact that the disallowed costs were incurred in satisfying a FERC-imposed duty to purchase gas from Kentucky West and pay the tariff rate for that gas. Second, the PUC's evaluation of the relative costs of alternative sources of supply is blind to the consequences of the minimum bill obligation. As long as Equitable's total gas purchases remained below minimum bill levels, as they did during the period in question, Equitable's true cost for gas purchased from a supplier other than Kentucky West was not simply the amount charged by that supplier. The cost of that gas would also include the minimum bill obligation that existed whether or not Equitable took gas from Kentucky West. For this reason, it is quite clear that, unless and until Equitable was relieved of its minimum bill obligation, purchasing gas from another supplier could never be cheaper than purchasing gas from Kentucky West. The PUC's contrary conclusion, without any mention of the minimum bill obligation whatsoever, conclusively demonstrates that it failed to take account of the minimum bill in assessing the relative cost of purchasing gas from a supplier other than Kentucky West.[15]

The court of appeals compounded the PUC's error. The court purported to recognize that Equitable might be entitled to relief under the filed rate doctrine if the PUC

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with controlling pre-emption doctrine" (FERC C.A. Br. 45). The FERC's reluctance to opine on the particulars of a dispute between private parties is understandable, but, as the discussion below makes clear, there can be little doubt that the PUC violated the filed rate doctrine.

[15] This conclusion is bolstered by the fact that the Public Service Commission of West Virginia, which expressly did take Equitable's minimum bill obligations into account, found that Equitable *had* been pursuing a lowest cost purchasing strategy. See C.A. App. 1068.

had failed to consider the minimum bill provision (see App., *infra*, 19a), but it went on to apply the doctrine in a manner that is squarely inconsistent with this Court's decision in *Mississippi Power*. The court held that Equitable had not properly raised its claim under the filed rate doctrine because Equitable had not established how the minimum bill provision was relevant to the costs disallowed by the PUC. The court found that Equitable's claim was precluded by the PUC's "finding", upheld by the Commonwealth Court, that the minimum bill provision was not relevant to the state-law prudence inquiry. *Id.* at 21a-22a.[16]

This Court's decision in *Mississippi Power* makes clear that state regulators' duty to take account of the provisions of FERC-approved tariffs does not depend upon the facts determined in the state-law prudence inquiry. The prudence inquiry is circumscribed by federal law, not vice versa. The decision below is wholly inconsistent with *Mississippi Power* because its allows state regulators to immunize their prudence determinations from scrutiny by making the "factual" finding that a FERC-approved tariff is not relevant in assessing the prudence of the utility's purchasing decisions. *Mississippi Power* makes clear that once the court of appeals determined that the minimum bill was part of the FERC-approved Kentucky West tariff, that court was obligated to conclude that the PUC had erred by failing to consider the effect of Equitable's minimum bill obligation on the prudency of Equitable's purchasing decisions.[17] Like the

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[16] Somewhat inconsistently, the court of appeals also faulted Equitable for allegedly failing to quantify its minimum bill liability in the district court. Of course, Equitable was not seeking relief with respect to its minimum bill obligation generally, but only with respect to the cost of federally required purchases actually made and paid for.

[17] In any event, Equitable plainly raised the connection between the claimed costs and the minimum bill before the PUC (see App., *infra*, 140a) and in the district court (see C.A. App. 268, 393-394, 424-425).

lower court in *Mississippi Power*, the court of appeals here simply failed to recognize that the filed rate doctrine requires state regulators to consider all of the provisions of FERC-approved tariffs when they evaluate the prudence of a utility's purchasing decisions.

2. The court of appeals did not have the benefit of this Court's decision in *Mississippi Power* at the time it decided this case. As we have discussed, the court below committed the same error as the lower court in *Mississippi Power* when it concluded that the PUC did not violate the Supremacy Clause by conducting its prudence inquiry outside the bounds permitted by the filed rate doctrine. For that reason, it is appropriate for this Court to grant this petition, vacate the judgment of the court of appeals, and remand the case to permit the court of appeals to reconsider its decision in light of the intervening decision in *Mississippi Power*.

Indeed, intervention by this Court is particularly appropriate because the application of the filed rate doctrine in the context of state statutes mandating review of a utility's gas purchasing decisions is a question of considerable importance.[18] Within the last five years more than a dozen states have, by statute or regulation, directed utilities to pursue least-cost purchasing strategies and required regulatory review of a utility's gas purchasing decisions. See Smoots, *Report on State Least-Cost Gas Purchasing Requirements*, 2 Natural Gas Lawyer's J. 110 (1987). The proliferation of state statutes mandating inquiries essentially identical to that conducted

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[18] The PUC's application of the Pennsylvania prudence statute, sanctioned by the court below, also conflicts with the approach advocated by other courts. In *Appeal of Sinclair Machine Products, Inc.*, 498 A.2d 696, 705 (N.H. 1985), for example, the court recognized that a state commission was not free to ignore selected portions of a FERC-approved rate, but that "the FERC rate alternative [should be] compared in its entirety against other available options." See also *Commonwealth Electric Co.* v. *Department of Public Utilities*, 397 Mass. 361, 491 N.E.2d 1035, 1045 (1986).

by the Pennsylvania commission means that the frequency of these inquiries is likely to increase dramatically. The decisions of the court of appeals and the Pennsylvania PUC could create considerable confusion regarding the application of previously-settled federal principles in this new procedural context. They should not be permitted to stand.

B. The Retroactive Application Of Act 74's New Ratemaking Standard Effected A Taking Of Equitable's Property Without Just Compensation.

1. The Takings Clause of the Fifth Amendment, applied to the states through the Due Process Clause of the Fourteenth Amendment, limits government authority to regulate "rates chargeable from the employment of private property devoted to public uses." *FCC* v. *Florida Power Corp.*, 107 S.Ct. 1107, 1113 (1987). This Court has used the term "confiscatory" as a shorthand description of government rate orders that violate the Takings Clause (*ibid.*). The PUC acted in an impermissibly confiscatory manner by retroactively applying a new ratemaking standard to bar Equitable from recovering expenditures that met the prudency standards that applied at the time those expenditures were incurred.[19]

Equitable adhered to a consistent gas purchasing strategy during the period from 1982, when demand first fell below minimum bill levels, through 1984. It addressed its oversupply of gas by reducing the amount of gas obtained from its pipeline suppliers on a pro rata basis. See page 5, *supra*. Prior to the adoption of Act 74, the PUC applied the "just and reasonable" standard (see 66 Pa. Cons. Stat. Ann. 1301 (Purdon

[19] This argument applies to the portion of the PUC's order barring Equitable from recovering purchased gas costs for the period prior to the effective date of Act 74—July 1983 through July 1984. Equitable incurred approximately $12 million of the disallowed costs during this period.

1979)) to allow Equitable to recover gas purchase costs incurred for the year 1982. The PUC specifically found that Equitable had utilized "prudent gas supply management" in view of the constraints imposed by the minimum bill provisions in the tariffs of its pipeline suppliers. *Gas Cost Rate No. 5*, 58 P.U.R. 369, 380 (Pa. P.U.C. 1984).

In an about-face, the PUC did not apply the general "just and reasonable" standard to evaluate Equitable's application for a rate increase to cover gas purchase costs incurred from July 1983 through July 1984—the period at issue in the present case. Even though Act 74 did not become effective until July 30, 1984, after Equitable had incurred the expenses that it sought to recover, the PUC applied the new ratemaking standard set forth in that statute, concluding that Equitable's costs were not allowable under the new statutory standard and denying Equitable's application for a rate increase. The PUC thus applied the Act 74 standard retroactively to prevent Equitable from recovering costs that previously had been found to be recoverable under the standard in effect at the time those costs were incurred. Such a retroactive change in the standard governing recovery of out-of-pocket costs plainly violates the Takings Clause.

The effect of government action upon the reasonable expectations of investors is an important factor in analyzing the permissibility of a rate order under the Takings Clause. Thus, a court reviewing a rate order "must determine whether the order may reasonably be expected to maintain financial integrity, attract necessary capital, and fairly compensate investors for the risks they have assumed, and yet provide appropriate protection to the relevant public interests, both existing and foreseeable." *Permian Basin Area Rate Cases*, 390 U.S. 747, 792 (1968); see also *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944) ("the return to the equity owner should be commensurate with returns on investments in other

enterprises having corresponding risks"). And the general standard for determining whether government action constitutes a taking looks in part to "the extent to which [the government action] interferes with investment-backed expectations." *Loretto* v. *Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 432 (1982); see also *Penn Central Transp. Corp.* v. *City of New York*, 438 U.S. 104, 124 (1978).

The key factor under all of these standards is whether the challenged government action upsets the investor's reasonable understanding of the risk that he assumed at the time he decided to make his investment. An important element of the investor's assessment of that risk in the context of a regulated company is the legal standard governing the company's ability to recover its out-of-pocket costs and earn a return on investment. Once the investor places his money at risk, he has an investment-backed expectation that the company's operations will be governed by the then-current legal standard. A prospective change in the legal standard does not interfere with this expectation—new investment will be withheld if the new standard increases risk without a commensurate increase in return.

A retroactive change in the applicable legal standard to bar recovery of previously-recoverable expenses or reduce the rate of return, however, raises serious issues. Because the additional risk that costs would be disallowed under changed regulatory policies was not known at the time the investment was made, the investor did not demand a rate of return commensurate with that risk.[20] Such a development not only causes the investor to lose the funds held to be nonrecoverable, but his remaining investment is riskier because more expenses

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[20] In this instance, the effect of the PUC's $14.3 million gas purchase cost disallowance was to reduce Equitable's rate of return on equity for the period in question to zero. C.A. App. 884.

could be retroactively disallowed in the future. For these reasons, a retroactive change in the governing legal standard, which bars recovery of costs incurred prior to the change in the legal rule although those costs previously had been recoverable, impermissibly interferes with investors' expectations in a manner that violates the Takings Clause.

The court of appeals concluded that Equitable waived its taking claim by "voluntarily" subjecting itself to the Act 74 standard, which the court thought could have been avoided by applying for a general rate increase rather than invoking the procedures for the recovery of gas purchase costs. See App., *infra*, 35a. The court's conclusion is wrong for the simple reason that the new Act 74 standard plainly applies to both types of ratemaking procedures. See 66 Pa. Cons. Stat. Ann. 1318(a) (Purdon 1988 Supp.). Accordingly, Equitable could not have avoided the injury it suffered by seeking a general rate increase.[21]

2. The question whether the Takings Clause permits the retroactive application of a new ratemaking standard to disallow costs that were recoverable under the ratemaking standard in effect at the time the costs were incurred is now before the Court in *Duquesne Light Co.* v. *Barasch*, No. 87-1160. The Supreme Court of Pennsylvania held in that case that a state statute barred utilities from recovering funds expended on the construction of nuclear power plants that were subsequently abandoned. The statute was adopted after the costs in question had been incurred, and the costs had been recoverable under the ratemaking standard in effect at the time they were incurred. The state court concluded that the

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[21] In addition, the applicable regulations *required* Equitable to use the purchased gas proceeding to seek a rate increase to recover actual gas costs in excess of revenues under its gas-cost tariff. See App., *infra*, 6a.

retroactive application of the new statute did not violate the Takings Clause.

The appellants in *Duquesne Light Co.*—like petitioners here—argue (see Br. 26-33) that the retroactive application of the statute effects a taking and that they are constitutionally entitled to recover through their retail rates out-of-pocket costs that were recoverable at the time they were incurred. In view of the close resemblance between the issue now before the Court in *Duquesne Light Co.* and the issue presented in this case, the Court should, if it does not remand on the *Mississippi Power* issue, hold the petition with respect to this question and dispose of it as appropriate in light of the disposition of *Duquesne Light Co.*

C. The PUC's Order Directing Equitable To Hire Separate Counsel Violates Equitable's Due Process Rights.

In alleged implementation of the duty imposed on Equitable by Act 74 to represent the interests of its ratepayers in FERC proceedings, the PUC ordered Equitable to retain separate counsel to participate in FERC proceedings in opposition to applications submitted to that body by Equitable's affiliate, Kentucky West. The court of appeals' conclusion that this extraordinary order comports with due process is inconsistent with the core function of the due process clause to guarantee "fundamental fairness." See, *e.g.*, *Walters* v. *National Ass'n of Radiation Survivors*, 473 U.S. 305, 320 (1985); *Lassiter* v. *Department of Soc. Services*, 452 U.S. 18, 24 (1981); see also *Joint Anti-Fascist Refugee Comm.* v. *McGrath*, 341 U.S. 123, 161 (1951) (Frankfurter, J., concurring) ("Fairness of procedure is 'due process in the primary sense' ") (citation omitted).

Although the process necessary to assure fundamental fairness varies depending on the circumstances, no process can be fair if it requires a participant to argue against its own perceived interests. Yet the PUC's order

does just that. It requires a parent company, Equitable Resources, to hire counsel to represent the customers of one of its subsidiaries, Equitable Gas, against its other subsidiary, Kentucky West. Such a procedure is totally unprecedented in Anglo-American jurisprudence. Indeed, this procedure

> misses a principle so plain and fundamental that I would think it would not need to be stated: Every citizen in this country is presumed to be unrestricted in consulting or employing an attorney on any matter, *or in making the decision that legal representation for any purpose is not needed.*

Walters, 473 U.S. at 371 n.22 (Stevens, J., dissenting) (emphasis added). "[T]he citizen's right to consult an independent lawyer and to retain that lawyer to speak *on his or her behalf* is an aspect of liberty that is priceless." *Ibid.* (emphasis added).

Although *Walters* ruled that Congress may establish informal administrative proceedings and discourage the participation of attorneys by limiting the amount they can be paid to a nominal sum, this Court has never held that a governmental body may force a party to appear at an administrative proceeding and, at the same time, require it to hire counsel to advocate a position that it does not wish to take. To the contrary, this Court has recognized that "lawyers, by training and disposition, are advocates and bound by professional duty to present all available evidence and arguments in favor of *their clients*' positions and to contest with vigor all adverse evidence and views." *Gagnon* v. *Scarpelli*, 411 U.S. 778, 787 (1973) (emphasis added); see also Friendly, "*Some Kind of Hearing*", 123 U. Pa. L. Rev. 1267, 1288 (1975) ("Under our adversary system the role of counsel is not to make sure the truth is ascertained but to advance his client's cause by any ethical means"); *Model Rules of Professional Conduct*, Rule 1.3, Comment (1983) ("A lawyer should act with commitment and dedication to the

interests of the client and with zeal in advocacy upon the client's behalf").

Because the PUC order is so totally at odds with Anglo-American legal tradition, it violates due process. See, *e.g.*, *Murray's Lessee* v. *Hoboken Land & Improvement Co.*, 59 U.S. (18 How.) 272, 277 (1856) (in determining whether a practice comports with due process, the court "must look to those settled usages and modes of proceeding existing in the common and statute law of England, before the emigration of our ancestors, and which are shown not to have been unsuited to their civil and political condition by having been acted on by them after the settlement of this country").

The PUC order also violates due process because it conflicts with substantive constitutional rights. See *Murray's Lessee*, 59 U.S. at 277 (in determining whether a practice violates due process, the court "must examine the constitution itself, to see whether this [practice] be in conflict with any of its provisions"). Specifically, because the PUC order requires Equitable to advocate a position with which it disagrees, the order impinges upon Equitable's First Amendment rights.

This Court has stated on several occasions that the protections of the First Amendment extend to speakers who have been compelled to disseminate or advocate views with which they disagree. See, *e.g.*, *Pacific Gas & Elec. Co.* v. *Public Util. Comm'n of California*, 475 U.S. 1, 16 (1986) (plurality opinion); *Harper & Row Publishing, Inc.* v. *Nation Enterprises*, 471 U.S. 539, 559 (1985); *Wooley* v. *Maynard*, 430 U.S. 705, 714 (1977); *Miami Herald Publishing Co.* v. *Tornillo*, 418 U.S. 241 (1974); *West Virginia State Bd. of Educ.* v. *Barnette*, 319 U.S. 624, 642 (1943); see also *id.* at 645 (Murphy, J., concurring). Thus, it is impermissible to "force[] speakers to alter their speech to conform with an agenda they do not set." *Pacific Gas*, 475 U.S. at 9

(plurality opinion). The speaker has "the right to be free from government restrictions that abridge its own rights in order to 'enhance the relative voice' of its opponents." *Id.* at 14 (citation omitted). Accordingly, "where the State's interest is to disseminate an ideology, no matter how acceptable to some, such interest cannot outweigh an individual's First Amendment right to avoid becoming the courier for such message." *Wooley*, 430 U.S. at 717.

The PUC's order is a pure example of impermissible compelled speech. The order requires Equitable to hire counsel to make arguments contrary to the interests of its sister company, Kentucky West. In other words, the order forces Equitable to make statements, through independent counsel acting on behalf of the ratepayers, with which it does not agree. Because the First Amendment fully applies to compelled speech, a governmental action requiring a person to disseminate information is constitutional only if it is a content-neutral and otherwise reasonable time, place, and manner restriction, *Pacific Gas*, 475 U.S. at 20-21 (plurality opinion), or if it is narrowly-tailored to achieve a compelling state interest. *Id.* at 19. The PUC order satisfies neither standard.

This Court's decision in *Pacific Gas* establishes that the order at issue here is not content-neutral. *Pacific Gas* involved an order of the California PUC requiring the appellant utility to include in its billing envelopes the newsletters of a consumer group that opposed it in ratemaking proceedings and with whose views it disagreed. The plurality held that the order was not content-neutral because it did "not simply award access to the public at large; rather, it discriminate[d] on the basis of the viewpoints of the selected speakers." *Pacific Gas*, 475 U.S. at 12 (plurality opinion). The order at issue here also discriminates on the basis of viewpoint. It requires Equitable to hire counsel to espouse a particular viewpoint, namely, one of support for ratepayers and opposi-

tion to Kentucky West's proposed tariffs. Therefore, like the order in *Pacific Gas*, the PUC order at issue here is not content-neutral.

The PUC order also fails the strict scrutiny test for governmental actions that discriminate on the basis of viewpoint. The State's interest in assuring low utility rates for its citizens may well be compelling. However, the order is not narrowly-tailored, because "the State can serve that interest through means that would not violate [Equitable's] First Amendment rights." *Pacific Gas*, 475 U.S. at 19. Specifically, in addition to FERC's own staff, consumer interests can be and are represented in FERC proceedings by state regulators. Indeed, both the PUC staff and Pennsylvania's Office of Consumer Advocate have taken active roles in ratemaking proceedings involving Kentucky West. There is no reason to think that Equitable's arguments in such FERC proceedings would add anything to those raised by the array of other advocates for the ratepayers' interests. Thus, requiring Equitable to finance two sets of attorneys and legal staffs to take opposing positions is in no way narrowly-tailored to achieve the State's interest in consumer protection.

In sum, the PUC's order requiring Equitable to hire attorneys to oppose Kentucky West in FERC tariff proceedings is neither content-neutral nor narrowly-tailored to achieve a compelling state interest. Therefore, the court of appeals' decision upholding it is inconsistent with this Court's First Amendment and due process jurisprudence.

CONCLUSION

The petition for a writ of certiorari should be granted, the judgment of the court of appeals vacated, and the case remanded for reconsideration in light of *Mississippi Power & Light Co.* v. *Mississippi*, No. 86-1970 (June 24, 1988). In the alternative, the Court should grant the petition or hold it for disposition as appropriate in light of the decision in *Duquesne Light Co.* v. *Barasch*, prob. jur. noted, No. 87-1160 (Mar. 7, 1988).

Respectfully submitted.

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